Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:MCT:CLE:TL-N-218-01
RSBloom

date: April 5, 2001

to: LM:NR:1486
Independence, OH
Attn: Robert Keller & Joe Solarz

from: Associate Area Counsel, LM:MCT:CLE

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subject: Advisory Opinion: TEFRA - Administrative Adjustment Request
[redacted]
Partnerships: [redacted], EIN: [redacted]
[redacted], [redacted], EIN: [redacted]
[redacted], EIN: [redacted]
Years: [redacted]

This memorandum responds to your request for assistance dated January 3, 2001. This memorandum should not be cited as precedent. As requested, we have reviewed [redacted] and the "amended" [redacted] Form 1065 filed by [redacted], [redacted] partnership with regard to the TEFRA rules. Please note that this memorandum is subject to 10-day post review by our National Office and, therefore, is subject to modification.

ISSUES

1. Whether [redacted] is a timely and otherwise proper request for administrative adjustment.

2. Whether the informal claim (entitled "[redacted] Interoffice Memorandum") submitted during the [redacted] audit constitutes a request for administrative adjustment on behalf of the [redacted], [redacted] partnership.

3. Whether the Service can, at this time, make an adjustment to [redacted]'s return based upon the "amended" Form 1065 of [redacted], [redacted] for the year [redacted]

CONCLUSIONS

1. For the years [redacted] and [redacted], [redacted] is neither timely nor proper as a request for administrative adjustment. For the year [redacted], the request is not proper. For the year [redacted], more information is needed in order to make a determination as to

whether the TEFRA provisions apply to such year.

2. The informal claim submitted during the [redacted] audit does not constitute a proper request for administrative adjustment on behalf of the [redacted], [redacted] partnership.

3. The statute of limitations for making assessments with respect to partnership items of the [redacted], [redacted] partnership for the year [redacted] has expired; therefore, the Service can no longer make any adjustment to [redacted]'s return based upon the "amended" [redacted] return.

FACTS

[redacted], a subsidiary of [redacted], was a partner in the following 3 partnerships:
1) [redacted] [hereinafter "[redacted]"]
2) [redacted] [hereinafter "[redacted]"]
3) [redacted] [hereinafter "[redacted]"]

Forms 1065, U.S. Partnership Return of Income, were filed by [redacted] on or about [redacted], [redacted], and [redacted], for the years [redacted], [redacted] and the short taxable year ended [redacted], respectively. Applications for extension of time to file were granted for each of the years to [redacted]. Included in the items deducted on the returns were intangible drilling costs ([redacted], [redacted] & [redacted]), [redacted] direct research expenditures ([redacted] & [redacted]) and contract research expenditures ([redacted] & [redacted]). For the years [redacted] through the short taxable year ended [redacted], [redacted] had 2 partners, both general. The partners were [redacted], the partnership's designated Tax Matters Partner, and [redacted]

On or about [redacted], a Form 1065, marked "AMENDED," was filed by [redacted] for its [redacted] taxable year. Included in the items deducted on the return were intangible drilling costs, [redacted] direct research expenditures and contract research expenditures. It was signed by the Tax Officer for [redacted], which was the partnership's TMP. The form supplied the corrected figures, reducing the partnership's deduction for depreciation from $[redacted] to $[redacted]. Attached to the form was corrected Schedule K-1's for the partners. Also attached was Form 8082, Notice of Inconsistent Treatment or Amended Return (Administrative Adjustment Request (AAR)). The form was marked "amended return (administrative adjustment request (AAR))" and set forth the following explanation: "received incorrect information regarding the amount of assets that qualified for depreciation." The depreciation amounts shown on the Form 8082 were the partnership amounts. However, neither box on the form

was checked in response to the question: If you are a TMP filing an AAR on behalf of the pass-through entity, are you requesting substituted return treatment? No action was taken by the Service with respect to this "amended return/AAR."

Form 1065 was filed by [redacted] on or about [redacted], for its initial short taxable year ended [redacted]. Applications for extension of time to file [redacted] initial return were granted to [redacted]. Included in the items deducted on the return was intangible drilling costs. [redacted] had 2 partners, both general. The partners were [redacted], the partnership's designated Tax Matters Partner, and [redacted]

Form 1065 was filed by [redacted] on or about [redacted], for the taxable year [redacted]. Applications for extension of time to file [redacted]'s [redacted] return were granted to [redacted]. Included in the items deducted on the return was intangible drilling costs. [redacted] had 5 partners, all general. The partners were [redacted], the partnership's designated Tax Matters Partner, [redacted], [redacted], [redacted] and [redacted].

During the audit of the [redacted], the examination team was, on [redacted], provided a document entitled "[redacted] Interoffice Memorandum." The text of the memorandum was as follows:

> Audit Adjustment Number 15 (Revised)
> Subject: Audit Adjustment For Years [redacted] & [redacted]
> Company Affected: [redacted]
> Reason For Adjustment: Revision to expenditures qualifying for research tax credit relating to [redacted] platform. Due to significant volume, detail is available for review upon request. See attached for a breakdown of 'as filed' versus 'as revised' [redacted] qualified research expenditures.
> [it then listed the increase (decrease) in qualified research expenditures and estimated tax effect for the years [redacted] and [redacted]]

The audit team, treating this as any other [redacted] claim, requested clarification by IDR ([redacted]) dated [redacted]. A response was received from [redacted] on [redacted]. The response set forth revised adjustments for the years [redacted], [redacted] and [redacted] with respect to [redacted], but never made any reference to a partnership. In fact, the audit team accepted the claim and began auditing the research amounts, not being aware that the claim related to a partnership.

On [redacted], the audit team for [redacted] received an "informal claim" entitled "[redacted] Federal Income Tax Audit Affirmative [redacted]." The document provided the following:

[redacted] Partnership

- Letter from [redacted] dated [redacted] for R & E in the amount of $[redacted] ([redacted]'s share) for the tax year [redacted].
- Letter from [redacted] dated [redacted] and related schedules for Section 174 deductions and Section 41 credits for the tax years [redacted] and [redacted].
- Letter from [redacted] dated [redacted] for Section 174 deductions in the amount of $[redacted] ([redacted]'s share is $[redacted]).

[redacted] Partnership

- Letter from [redacted] dated [redacted] and related schedules for Section 174 deductions and Section 41 credits for the tax years [redacted] to [redacted].

Please note that the deductions claimed above for [redacted] and [redacted] result from a reclassification from IDC to Section 174.

The above claim was submitted on [redacted] to meet the [redacted], drop dead claim date which was set in the audit plan. Informal claims in this format are customarily received and accepted in the large case audits. In response to the claim, the examiners issued an IDR ([redacted]) on [redacted], requesting detail in support of the claim. [redacted]'s response was received [redacted]. It stated that "[t]he information requested in this IDR relates to [redacted] and [redacted] which during [redacted] through [redacted] were tax partnerships for which [redacted] served as the TMP. Affirmative claim number [redacted] is based on the affirmative claims filed by [redacted] on behalf of these tax partnerships." No underlying documentation supporting the claim has been provided by [redacted]. The Service has taken no other action with respect to [redacted].

No partnership audit was ever started for the 3 partnerships for the years [redacted] through [redacted], and no consent to extend the time to assess partnership items (Form 872-P) has been executed for the partnerships. The consents to extend the time to assess tax, which were executed by [redacted], do not include reference to any of the 3 partnerships.

LAW

For the years through [redacted], the provisions under TEFRA (Tax Equity and Fiscal Responsibility Tax Act of 1982) apply to the partnerships in issue. For these years, the small partnership exception (partnerships with 10 or fewer partners) only applied to partnerships consisting of individuals or estates. However, the Taxpayer Relief Act of 1997 (TRA'97) amended I.R.C.§ 6231(a)(1)(B)(i) to provide that partnerships with C corporation partners could fall under the small partnership exception. The amendment applies to partnership tax years ending after [redacted]. Provided the partnerships had only the partners they had during the year [redacted], they fit within the small partnership exception. Consequently, unless they made an election under section 6231(a)(1)(B)(ii) to have the TEFRA provisions apply, the unified audit procedures of TEFRA would not apply for the partnerships' [redacted] tax year. Such an election to have TEFRA apply is made by attaching a statement to the partnership return in accordance with Treas. Reg. § 301.6231(a)(1)-1T(b)(2).

Under section 6222(a), "[a] partner shall, on the partner's return, treat a partnership item in a manner which is consistent with the treatment of such partnership item on the partnership return." Treas. Reg. § 301.6221-1T(a) provides, in part, that "[a] partner's treatment of partnership items on the partner's return may not be changed except as provided in sections 6222 through 6231 of the Code and the regulations thereunder." A partnership item is "any item required to be taken into account for the partnership's taxable year ...to the extent regulations ... provide that ... such item is more appropriately determined at the partnership level than at the partner level." I.R.C.§ 6231(a)(3). Treas. Reg.§ 301.6231(a)(3)-1(a) sets forth various items which are more appropriately determined at the partnership level and, therefore, are partnership items. Included in this list are items of income, gain, loss, deduction, or credit of the partnership. Treas. Reg.§ 301.6231(a)(3)-1(a)(1)(i). The term "partnership item" also includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss or deduction (e.g., elections made by the partnership; activities engaged in for profit). Treas. Reg.§ 301.6231(a)(3)-1(b).

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[1]We were not provided copies of the [redacted] Forms 1065 of the partnerships.

There are no per se "amended returns" under TEFRA for partnership items; rather, the TEFRA provisions provide for an Administrative Adjustment Request [hereinafter "AAR]. AARs can be filed by the partnership's tax matters partner [hereinafter "TMP"] on behalf of the partnership or by individual partners (including the TMP) on their own behalf. Section 6227. Any such AAR must be filed within 3 years after the later of the date on which the partnership return is filed or the last day for filing the partnership return (without regard to extensions), and before the mailing to the TMP of a notice of final partnership administrative adjustment [hereinafter "FPAA"]. Section 6227(a). The period for filing an AAR is extended for the period within which an assessment may be made pursuant to an agreement under section 6229(b) and for 6 months thereafter. Section 6227(b).

An AAR filed by the partnership's TMP may be treated as a substituted return, if so requested by the TMP. In such case, the Service may treat the changes shown on such request as corrections of mathematical or clerical errors appearing on the partnership return. I.R.C.§ 6227(c)(1). If so treated, appropriate assessments can be made without a partnership proceeding provided the partners, within 60 days after the day on which notice of the correction of the error is mailed to the partners, do not file with the Service a request that the correction not be made. I.R.C. § 6230(b). An AAR requested by the TMP to be a substituted return remains an AAR even if the Service fails to grant the request. Treas. Reg.§ 301.6227(b)-1T(b). If an AAR is not treated as a substituted return, the Service may: 1) allow the credits or refunds arising from the requested adjustments, 2) conduct a partnership proceeding, or 3) take no action. I.R.C.§ 6227(c)(2).

Section 6227 does not provide for the issuance by the Service of any notice of claim disallowance as exists with non-TEFRA claims for refund. However, if any part of the AAR filed by the TMP is not allowed, the TMP may file a petition for an adjustment with the Tax Court, district court or the Claims Court. I.R.C.§ 6228(a)(1). The time for filing the petition is the period beginning 6 months after the AAR was filed and ending 2 years after it was filed.[2] I.R.C.§ 6228(a)(2). However, no petition can be filed after the Service mails a partnership a notice of the beginning of an administrative proceeding with respect to the partnership taxable year to which the AAR relates. I.R.C.§ 6228(a)(2)(B).

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[2]Under section 6228(a)(2)(D), the 2-year period can be extended by written agreement.

If a partner (including the TMP) files an AAR on its own behalf, the Service may: 1) allow the claim for credit or refund; 2) assess any additional tax resulting from the adjustments, 3) mail to the partner a notice converting the partnership items of the partnership for the taxable year to which the request relates to nonpartnership items, or 4) conduct a partnership proceeding. I.R.C.§ 6227(d).[3]

If any part of the partner's claim is not allowed, the partner may bring suit under section 7422 for the credit or refund attributable to the items not allowed in the AAR. The time for filing suit is as follows:

1) If the Service mailed the partner a notice that the items covered in the AAR were converted to nonpartnership items, the suit may be brought anytime within 2 years of the mailing of such notice; and

2) If the Service did not mail a notice converting the partnership items, the suit may be brought during the period beginning 6 months after the filing of the AAR and ending 2 years after the AAR filing.[4] I.R.C. § 6228(b)(1)(B) and (b)(2)(B).

Treas. Reg. §§ 301.6227(b)-1T(a) and 301.6227(c)-1T provide that the AAR (whether made by the TMP on behalf of the partnership or by a partner on its own behalf) is to be filed on the form prescribed by the Service in accordance with the instructions accompanying the form. Form 8082, Notice of Inconsistent Treatment of Administrative Adjustment Request (AAR), is the prescribed form for making an AAR. In accordance with the instructions for Form 8082, a TMP filing an AAR must:

1) file an amended Form 1065 without entering any amounts on the form itself;

2) attach Form 8082, answer the question on line 2, and identify the amount and treatment of any item that is being changed from the way it was reported on the original return;

3) the TMP must sign the amended return;

4) if substituted return treatment is requested, enter in the top margin of the amended return "See attached Form 8082 for AAR per IRC section 6227(c)(1);"

5) if substituted return treatment is not requested, enter

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[3]Although not stated in section 6227(d), it appears the Service would also have the option of taking no action. This option is specifically stated in section 6227(c) with respect to an AAR filed by the TMP for the partnership.

[4]No suit may be filed after the Service mails to the partnership a notice of beginning of a partnership proceeding. I.R.C.§ 6228(b)(2)(C). Also, the 2-year period can be extended by written agreements. I.R.C.§ 6228(b)(2)(B)(ii).

in the top margin of the amended return "See attached Form 8082 for AAR per IRC section 6227(c)(2);"

6) attach amended Schedules K-1 showing the corrected amounts for each partner;

7) complete Form 8082; and

8) file it with the Service Center where the original partnership return was filed.

In accordance with the instructions on Form 8082, a partner filing the form must:

1) complete Form 8082; and

2) file Form 8082 in duplicate; the original copy is filed with the partner's amended income tax return and the other copy is filed with the service center where the partnership return is filed.

The instructions also state that "[y]ou must complete and file a separate form for each pass-through entity for which you are reporting an inconsistent or AAR item."

The Tax Court has held that section 6227 does not authorize the Service to consider a nonconforming AAR. Phillips v. Commissioner, 106 T.C. 176, 181 (1996). See also Rothstein v. United States, 98-1 U.S.T.C. ¶ 50,435 (Fed. Cl. 1998), where the U.S. Court of Federal Claims upheld strict adherence to the TEFRA provisions. The Phillips Court held that "[a]s an express legislative prescription, these procedures [Sec. 6227; secs. 301.6227(b)-1T and 301.6227(c)-1T] apparently supersede the discretionary administrative standards and case law governing the acceptance of amended returns generally: a partner's treatment of partnership items on his return may not be changed except in accordance with these procedures. Sec. 301.6221-1T(a)." Phillips at 180. The taxpayer in Phillips failed to file Form 8082 with his amended tax return and, therefore, his request to change the treatment of a partnership item did not conform to the requirements of section 6227.

Although Treas. Reg.§ 301.6402-3 provides that claims for refund shall be made on Form 1040X or 1120X, the courts have consistently recognized informal claims for refund as legally binding. In most instances where an informal or defective claim is ruled to be sufficient, it is because the Service has been found to have waived any defect that is present. United States Pipe & Foundry Co. v. United States, 155 F. Supp. 231 (Ct. Cl. 1957). However, such a waiver will not be found unless there is an unmistakable showing that the Service has dispensed with the formal requirements of the regulations and considered the claim for refund on its merits. Angelus Mining Co. v. Commissioner, 325 U.S. 293 (1945).

Under section 6229(a), the period for assessing any tax attributable to any partnership item for a partnership taxable year shall not expire before the date which is 3 years after the later of the date on which the partnership return was filed or the last day without regard to extensions for filing such return. This period can be extended by agreement with respect to any individual partner or with respect to all partners. I.R.C. § 6229(b). As a general rule, no assessment of a deficiency attributable to any partnership item can be made without a partnership level proceeding being completed. I.R.C.§ 6225(a).

ANALYSIS

Requests for administrative adjustment relate only to partnership items. [redacted] relates to a reclassification of deductions claimed by the partnerships from IDC to section 174, which also could result in increases to the section 41 credit. The "amended" [redacted] Form 1065 of [redacted] relates to a decrease in depreciation deductions claimed by the partnership. All these items are certainly more appropriately determined at the partnership level than at the partner level (deductions of the partnership, and accounting practices and legal and factual determinations underlying the determination of the amount of credit and deduction). Thus, the documents in issue relate to partnership items.

1. [redacted] was received by the Service on [redacted], which date is more than 3 years after both the filing of [redacted]'s [redacted] and [redacted] partnership returns and their due dates. Therefore, [redacted], if otherwise proper, was untimely for the years [redacted] and [redacted]. With respect to the year [redacted], although arguably timely, [redacted] was not properly prepared or filed and, therefore, is invalid as an AAR. As mentioned above, the Service is not authorized to consider an AAR which is not in compliance with the TEFRA procedures as set out in the regulations. [redacted] fails to comply in almost every respect: a) its form was improper: no Form 1120X or Form 8082; b) the claim did not contain all the information that is required on the Forms 1120X and 8082; c) it was not "filed" properly: Form 8082 must be filed in duplicate (with 1120X and with Service Center where partnership return is filed); and d) there was only 1 claim for all the partnerships: a separate form is needed for each pass-through entity. The filing of proper AARs with respect to the [redacted] year of the partnerships is now time barred. With respect to the year [redacted], a determination cannot be made from the information thus far provided as to whether the TEFRA provisions apply. It appears that the partnerships, unless they elected otherwise, would fall within the small partnership exception and

thus outside the TEFRA provisions. In such case, the claim, if considered on the merits, may be considered a valid informal claim. However, we need to view, at a minimum, the partnership returns for the year [redacted] to determine whether TEFRA applies to the partnerships' [redacted] year.

2. Although the TMP of a partnership can file an AAR on behalf of the partnership, the informal claim (entitled "[redacted] Interoffice Memorandum") does not constitute such. First, it does not comply with the requirements of an AAR. Second, the informal claim clearly states on its face that it relates to [redacted] ([redacted]); there is nothing indicating that it relates to a partnership. In fact, the agents receiving the informal claim were not aware that it had any relationship to a partnership. Finally, the informal claim, even if valid as a partnership AAR, has no validity any longer. No formal action was taken by the Service with respect to it; therefore, the TMP had only 2 years to bring suit with regard to it, which time has expired.

3. The [redacted] Form 1065 of [redacted] was filed on or about [redacted]. An "amended" [redacted] return was filed by [redacted]'s TMP on or about [redacted]. The item adjusted on the "amended" return was depreciation, clearly a partnership item. No action was taken by the Service with respect to the original or "amended" return. The TMP also took no action with respect to the "amended" return. Also, no consent to extend the statute of limitations with respect to the partnership was obtained from the TMP or the individual partners. Consequently, the 3-year assessment period with respect to the partnership items of [redacted] has expired for the year [redacted]. The filing of an AAR does not extend the statute of limitations for assessing partnership items, so it is irrelevant whether the "amended" return constitutes a valid AAR on behalf of the partnership. Therefore, any adjustment to the depreciation deduction claimed by [redacted], which is attributable to the partnership, is barred by the expiration of the partnership statute of limitations.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views. Also, if you have any questions regarding the above, please feel free to contact the undersigned at 216-522-3380 (ext. 3108).

JOSEPH F. MASELLI
Area Counsel
(Heavy Manufacturing, Construction and Transportation:Edison)

By:_____
RICHARD S. BLOOM
Associate Area Counsel
(Large and Mid-Size Business)